No. 20567

United States
COURT OF APPEALS
for the Ninth Circuit

ALONZO W. DERING,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of Eldon P. Dering, bankrupt,

Appellee.

APPELLEE'S ANSWERING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

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STATEMENT OF JURISDICTION

The appellee-plaintiff, Everett H. Williams, trustee in bankruptcy of Eldon P. Dering, bankrupt, commenced this suit in the United States District Court for the District of Oregon to recover certain moneys from appellant-defendant, Alonzo W. Dering. Jurisdiction was based upon Section 67(e) of the Bankruptcy Act, 11 U.S.C. 107(e).

After a trial before the Honorable William T. Beeks, Judge of the United States District Court, and a hearing on objections of the appellant to Findings of Fact and Conclusions of Law proposed by the Court, a judgment based upon Findings of Fact and Conclusions of Law was entered in favor of the appellee in the sum of $14,-120.00, together with interest at the rate of 6% from June 30, 1964, and costs and disbursements. This is an appeal by the appellant from said judgment.

STATEMENT OF FACTS

The appellant and his brother, the bankrupt (also known as Mike Dering), organized Dering Industries, Inc., an Oregon corporation, in 1951. The corporation, which was engaged in the manufacture and sale of aluminum fence gates, was managed by the appellant from the time of its inception (Tr. 6). It maintained offices in an office and warehouse building owned by the bankrupt, who also rendered services for the corporation when the appellant was away (Tr. 6). The appellant and the bankrupt were officers and directors of the corporation until its sale in 1964 (Tr. 23).

Two hundred shares of capital stock were issued, 100 shares each to the appellant and the bankrupt. On September 30, 1951, the appellant and the bankrupt executed reciprocal options for the purchase of the stock of the other. Said options are set forth in the Pre-Trial Order (R. 28-30). The appellant and the bankrupt each held separate stock certificates for 100 shares of stock until December 6, 1961 (Tr. 6).

On December 6, 1961, the bankrupt being in financial difficulties and in need of money, obtained $10,000 from the appellant. At the same time the bankrupt endorsed and delivered his stock certificate to the appellant who in turn executed and delivered to the bankrupt a document entitled "OPTION TO PURCHASE STOCK." This document, set forth in the Pre-Trial Order (R. 30-31), purported to give the bankrupt the exclusive right and option for a period of 180 days from the date thereof to purchase the 100 shares of stock for $10,000 plus interest at the rate of 6 percent. The stock certificate was not transferred nor a new certificate issued on the books and records of the corporation at that time (Tr. 10).

On June 6, 1962, the bankrupt repaid the appellant the sum of $3,000 (R. 31; Tr. 11). On the same date the appellant executed and delivered to the bankrupt another document entitled "OPTION TO PURCHASE STOCK," set forth in the Pre-Trial Order (R. 31), purporting to give the bankrupt the exclusive right and option for a period of 180 days from the date thereof to purchase 70 shares of stock for the sum of $7,000 plus interest at the rate of 6 percent.

On December 6, 1962, the bankrupt repaid the appellant the further sum of $3,000 (R. 32; Tr. 11, 13). On the same date the appellant executed and delivered to the bankrupt a document likewise entitled "OPTION TO PURCHASE STOCK," set forth in the Pre-Trial Order (R. 32), purporting to give the bankrupt the exclusive right and option for a period of 180 days from

the date thereof to purchase *48* shares of capital stock for the sum of $4,800 plus interest at the rate of 6 percent.

Notwithstanding these repayments the appellant continued to hold the stock certificate originally issued to the bankrupt and endorsed to the appellant on December 6, 1961, and no new certificates of stock were issued either to the appellant or the bankrupt on these two occasions (Tr. 10).

The so-called option given the bankrupt after the first repayment of $3,000 on June 6, 1962, reduced the amount of stock which the bankrupt had a right to purchase from 100 shares to 70 shares. Appellant's explanation was that the bankrupt had "repurchased" 30 shares at the rate of $100 per share (Tr. 11). The so-called option given on the occasion of the second repayment of $3,000 on December 6, 1961, reduced the amount of shares which the bankrupt had a right to repurchase from 70 to 48 shares; that is the bankrupt, according to appellant, had this time "repurchased" only 22 shares for $3,000. Appellant explained the difference in the number of shares received by admitting that some portion of the amount received by him had been applied to interest (Tr. 13).

On February 20, 1963, the bankrupt, again being in need of money, obtained $5,850 from the appellant (R. 32; Tr. 13), who at the same time executed and delivered to the bankrupt a document entitled "OPTION," set out in full in the Pre-Trial Order (R. 32-34), purporting to give the bankrupt an option to purchase 100

shares of stock on the terms and conditions set forth in said document. At this time the certificate originally issued to the bankrupt was cancelled and a new certificate was issued to the appellant (R. 34; Tr. 13).

On March 4, 1964, there was a further transaction between the parties which did not involve any transfer of funds. At that time both parties executed the final document relating to the corporation and its stock, entitled "AGREEMENT — BETWEEN ALONZO W. DERING AND ELDON P. DERING, set forth in the Pre-Trial Order (R. 34-35), which agreement provided for the sale or liquidation of the corporation. Unlike the four prior documents, all of which were designated "OPTIONS,"* the document dated March 4, 1964, is entitled "AGREEMENT." Also it is the only document to which both parties were signatories, all of the so-called option documents being executed solely by the appellant.

What were the circumstances obtaining at that time, that is March 4, 1964? The bankrupt had been in financial difficulties for some time. A number of lawsuits against him had proceeded to judgment. The bankrupt had been forced to cease his rose-growing and nursery business, and also to sell his inventory and surrender his office and warehouse by November 1, 1963 (R. 36; Tr. 14, 17-19). In fact, he had terminated his operations in the summer, or in any event by September of 1963 (Tr. 55). On November 1, 1963, and thereafter, he

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* These documents dated December 6, 1961, June 6, 1962, December 6, 1962, and February 20, 1963, are sometimes hereinafter referred to as the so-called option documents.

was admittedly insolvent (R. 36; Tr. 17). The appellant for a long time had been aware of his brother's financial difficulties and of his insolvency on November 1, 1963, and thereafter (R. 37; Tr. 17).

Further, on that date, that is March 4, 1964, Dering Industries, Inc. had in excess of $20,000 in cash in the bank plus accounts receivable, inventory and equipment, and no outstanding debts of any kind (Tr. 27, 114-115; Ex. 22). Moreover, it had a franchise from Life-Time Gate Co., a subsidiary of Moncrief-Lenoir, to whom the stock of the corporation was thereafter sold. The franchise was, and for two or three years prior thereto had been, valued by the appellant at $25,000 (Tr. 64-66, 79-80) and was almost immediately thereafter sold on March 27, 1964, for $25,000, that is a value of $25,000 was placed on the franchise, in addition to the value of the other assets, in determining the purchase price of the stock (Tr. 27, 78-80; Exs. 29, 34).

By March 4, 1964, the appellant had determined, because of the bankrupt's financial difficulties and the impending loss of the building in which the corporation's offices were located (Ex. 22), to sell or liquidate the corporation. The day previous, on March 3, 1964, he had written to Moncrief-Lenoir (Ex. 22) relative to a possible sale. After some indication that Moncrief-Lenoir was not interested in the purchase of the corporation (Tr. 28, Ex. 28) and some negotiations between the appellant and Mr. Zanley Galton, president of Western Wire Works (Tr. 28-30), an agreement for the sale of the stock of the corporation, including the sum of

$25,000 for the franchise, was reached in a long-distance telephone conversation between the appellant and Frank Lenoir and confirmed by letter the following day, that is, March 27, 1964 (Tr. 27-28, 63; Ex. 29).

It would appear there was no question concerning the ultimate consummation of the purchase and sale transaction and the appellant took certain steps and immediately corresponded with the purchaser relative to various matters predicated thereon (Ex. 30, 31). Possession of the physical assets was taken by the purchaser on or about June 1, 1964 (Tr. 32), although the final determination of the purchase price and payment thereof was not made until July 1, 1964, when the appellant received the total sum of $50,241 (Tr. 115; Ex. 34).

In the meantime the bankrupt filed a voluntary petition in bankruptcy on April 16, 1964 and was adjudicated a bankrupt (R. 27).

The salaries and profits of the corporation were distributed to the appellant and the bankrupt on an annual basis at the close of each fiscal year (Tr. 53, 55). As a practical matter, appellant admitted that salaries were adjusted at the close of each year in an effort to absorb all of the profits of the corporation (Tr. 55).

The appellant has conceded that profits were shared with the bankrupt until the close of the fiscal year on May 31, 1963 at which time the bankrupt received $3,000 (Tr. 21-22). The appellant testified that only $600 was paid the bankrupt for the fiscal year ending May 31, 1964, despite the fact the bankrupt admittedly performed no services subsequent to September, 1963.

There were no minutes or other records providing any basis or explanation for any profit or salary adjustments subsequent to May 31, 1963 (Tr. 23-24). It should be noted that of the $600 payment to the bankrupt for the final year the portion for the period commencing with June 1, 1963, and ending with the date the bankruptcy petition was filed was paid to appellee as trustee in bankruptcy (Tr. 77-78), and only the portion of the salary payment for the period subsequent to the filing of the petition was paid to the bankrupt (Tr. 77-78).

As appellee has pointed out in his brief (Br. 16), the schedules filed by the bankrupt did not list the appellant as a creditor (Ex. 1). Neither did the bankrupt's schedules list the corporation stock or the agreement of March 4, 1964 among the assets (Tr. 103, Ex. 1).

SUMMARY OF ARGUMENT

The appellant has assigned three specifications of error with respect to which the appellee's argument is as follows:

1. Specification of Error 1.

The four so-called option documents dated December 6, 1961, to February 20, 1963, inclusive, were security devices for loans made by the appellant to the bankrupt.

a. The evidence clearly supports such finding.

b. The trial court properly made its findings upon the basis of the evidence presented and not upon the theory upon which the parties may have tried the case.

Hormel v. Helvering, 312 U.S. 522, 61 S. Ct. 719, 85 L. Ed. 1037 (1940).

United States v. Bess, 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958).

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).

Massachusetts Bonding & Insurance Co. v. State of New York, 2 Cir., 259 F.2d 33 (1958).

2. Specification of Error 2.

The agreement of March 4, 1964, superseded any and all prior agreements, options and understandings and was made in contemplation of the sale or liquidation of the stock or assets of the corporation; and accordingly the trial court properly disregarded the appellant's contention based upon the option dated September 30, 1951.

3. Specification of Error 3.

a. The evidence clearly supports the findings that within one year prior to the adjudication in bankruptcy and at a time when the bankrupt was insolvent, he transferred his equitable interest in the 100 shares of corporation stock to the appellant, that said transfer was without fair consideration and that the value of the bankrupt's equitable interest at the time of transfer was $25,120.

b. These findings are not inconsistent with the finding that the four so-called option documents of December 6, 1961, to February 20, 1963, inclusive, were security devices. The agreement of March 4, 1964, was not a security device but an agreement for sale or liquidation of the corporation.

c. The appellant's contentions as to the Pre-Trial Order, the inadequacy of the appellee's contentions and Finding 10 have no validity.

(1) A pre-trial order is to be liberally construed and the court may consider issues not framed therein and make findings of fact relative thereto.

3 Moore, Federal Practice, 2d Ed. 1132.
Smith Contracting Corp. v. Trojan Const. Co., Inc., 10 Cir., 192 F.2d 234 (1951).
Rosden v. Leuthold, C.A., D.C., 274 F.2d 747 (1960).
Scott v. Spanjer Bros., Inc., 2 Cir., 298 F.2d 928 (1962).
Century Refining Co. v. Hall, 10 Cir., 316 F.2d 15 (1963).
Clark v. Pennsylvania Railroad Company, 2 Cir., 328 F.2d 591 (1964).

(2) A pre-trial order may be amended to permit a court to make findings and the court may amend by making findings.

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).
American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 9 Cir., 292 F.2d 640 (1961).
Interstate Plywood Sales Co. v. Interstate Container Corp., 9 Cir., 331 F.2d 449 (1964).
Brucker v. United States, 9 Cir., 338 F.2d 427 (1964).

(3) A pre-trial order is amended by implied consent by the introduction of evidence without objection and issues so tried are treated as if raised in the pleadings.

Southern Pacific Co. v. Libbey, 9 Cir., 199 F.2d 341 (1952).

Shelley v. Union Oil Co. of Cal., 9 Cir., 203 F.2d 808 (1953).

Glens Falls Indemnity Company v. United States, 9 Cir., 229 F.2d 370 (1955).

Kirk v. United States, 9 Cir., 232 F.2d 763 (1956).

Hall v. National Supply Co., 5 Cir., 270 F.2d 379 (1959).

Rosden v. Leuthold, C.A., D.C., 274 F.2d 747 (1960).

June T., Inc. v. King, 5 Cir., 290 F.2d 404 (1961).

Securities and Exchange Commission v. Rapp, 2 Cir., 304 F.2d 786 (1962).

3 Moore, Federal Practice, 2d Ed. 983, 984.

(4) Where issues are tried a court must make findings thereon.

3 Moore, Federal Practice, 2d Ed. 996.

Securities and Exchange Commission v. Rapp, 2 Cir., 304 F.2d 786 (1962).

The appellee further makes the following

4. Argument for Affirmance of Judgment.

The judgment of the trial court must be affirmed unless its findings of fact are clearly erroneous.

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).

American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 9 Cir., 292 F.2d 640 (1961).

ARGUMENT

1. Answer to Appellant's First Specification of Error

Appellant's first specification of error is:

"The District Court erred in finding:

'4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt.' (R. 88 Findings etc.)

on the grounds and for the reasons:

"a. The evidence was insufficient to establish the purported fact;

"b. Such finding was inconsistent with the theory upon which the appellee tried the case."

In his argument thereon the appellant sets forth some factors to be considered in determining whether a particular transaction is a sale with an option back or a security transaction. His statement of the factors consists of generalized statements of language appearing in *Blue River Sawmills Ltd.* v. *Gates,* 225 Or. 439, 358 P.2d 239 (1960). The appellant then suggests that the evidence should be tested in the light of the factors enumerated, proceeds to make a few brief references to some of the testimony and the documentary evidence and to the memorandum decision of the trial court, and concludes that "the preponderance of the evidence does

not establish that the various transactions were security devices" (Appt's. Br. 10, 18).

It is submitted that the appellant has either failed to note or deliberately overlooked a substantial amount of testimony and documentary evidence, including provisions of the four so-called option documents, which clearly establish the contrary. Of greater importance is the fact, which the appellee wishes to emphasize, that the appellant has erroneously interpreted Finding 4 as including the agreement of March 4, 1964 among the "option documents * * * intended to constitute security devices for loans made by the defendant to the bankrupt" (R. 88). It should be noted that Finding 4 relates to "transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant" and that no transfer of funds was involved in the March 4, 1964, transaction. It is undoubtedly because of this erroneous interpretation of Finding 4 that the appellant urges as his second specification of error that the District Court erred in refusing to give force or effect to the option agreement of September 30, 1951, and the appellant's exercise thereof (Appt's. Br. 10, 19), and that he contends in his third specification of error that Findings 6 and 8 on the one hand are inconsistent with Finding 4 on the other (Appt's. Br. 10, 21). The appellee will discuss this observation in detail in his answer to the appellant's third assignment of error. The appellee at this point deems it sufficient to observe that the agreement of March 4, 1964, was not intended as a security device nor was it regarded as such

by the trial court when he entered the findings of fact, conclusions of law and judgment.

Let us consider some of the evidence. There were four so-called option documents executed betwen December 6, 1961, and February 20, 1963. Each of these documents fixed the price to be paid to the appellant for the "repurchase" of the designated number of shares of stock referred to therein at an amount precisely equal to $100 per share plus interest at the rate of 6% per annum. The appellant testified that he had charged interest when the second repayment of $3,000 was made by the bankrupt on December 6, 1961 (Tr. 13). How the interest was computed he did not know. In any event, $3,000 was paid for 22 shares purportedly repurchased by the bankrupt, an amount in substantial variance from the price of $100 per share specified in the so-called option document dated June 6, 1962. Likewise, the amount advanced by the appellant to the bankrupt on February 20, 1963, $5,850, was at substantial variance from the price of 52 shares at that time presumably again "purchased" from the bankrupt.

The recital in the so-called option document of June 6, 1962 that the bankrupt had theretofore transferred 70 shares to the appellant and the similar recital in the so-called option document dated December 6, 1962 that the bankrupt had theretofore transferred 48 shares to the appellant are inconsistent with what the appellant has contended, namely that he purchased 100 shares from the bankrupt on December 6, 1961, and that the bankrupt had repurchased 30 shares and an additional

22 shares during 1962. These recitals, if they are at all meaningful, are consistent only with pledges of 70 and 48 shares respectively and the word "transferred" in the recitals properly should be read as "transferred as collateral security."

Notwithstanding the purported purchase of 100 shares of the bankrupt's stock originally on December 6, 1961, the purported repurchases of 30 shares and 22 shares by the bankrupt during 1962 and the purported repurchase of 52 shares by the appellant on February 20, 1963, the bankrupt continued to share in profits until June, 1963 (Tr. 21-22). This sharing in profits, as noted by the trial court in its memorandum opinion, is inconsistent with the appellant's theory of a purchase and sale of the bankrupt's stock and is consistent only with the analysis of the court and Finding 4 that these transactions involved loans and that the so-called option documents were security devices.

The appellant's observation in his brief on page 18 that "the undisputed evidence was that at the yearly corporate meeting after the February 20, 1963 transaction, the compensation of the bankrupt, to be received by him from Dering Industries, Inc. was reduced from $3,000.00 per year to $600.00 per year (Tr. 77)" is simply not corect. The minutes of the meetings are in evidence (Exs. 41, 42). The trial court made express inquiry relative thereto (Tr. 23) and counsel for the appellant stated that there was no provision in the minutes relative to compensation or profits (Tr. 23). Further, Exhibit 22, being a letter dated March 3, 1964, from the appellant

to Moncrief-Lenoir specifically states that the appellant still kept the bankrupt on the payroll and "divide the profits with him." Finally, profits as noted were adjusted at the close of each year (Tr. 53, 55). The reduction of the bankrupt's share to $600.00 was a unilateral action of the appellant (Tr. 22-23), made in June, 1964, after the agreement of March 4, 1964, after the petition in bankruptcy had been filed on April 16, 1964, and after the appellant knew that a major portion of the salary or profits received by the bankrupt would have to be paid to the trustee in bankruptcy and not to the bankrupt himself.

The appellant has observed in his brief (Br. 16) that the statement of affairs filed with the petition in bankruptcy recited that the option had been released (Ex. 1) and that the appellant was not listed as a creditor in the schedules filed in bankruptcy (Ex. 1). With respect thereto it is sufficient to note that these facts are completely consistent with the sale and transfer of the stock to the appellant on March 4, 1964.

The only other observation made by appellant is the fact that the bankrupt was not called as a witness. As the defendant admitted, the bankrupt had suffered a heart attack in 1955 (Tr. 15), he had been ill on various occasions subsequently thereto, and for a period the bankrupt's son Patrick had run the business (Tr. 14-15) and he was and had been, at least from October, 1964, in Phoenix, Arizona (Tr. 5). It must further be presumed that the bankrupt had no particular interest in the outcome of the litigation except such as might derive from his family relationship to the appellant.

The financial needs of the bankrupt, a fact sought to be glossed over by the appellant by his observation that "the appellant knew bankrupt wanted money but did not know the reason" (Appt's. Br. 16) is material in considering whether these transactions were loans or otherwise. In *Blue River Sawmills Ltd.* v. *Gates,* 225 Or. 439, 461, 358 P.2d 239 (1960), cited by the appellant, the fact that the party seeking funds is in financial distress is recognized as a highly important consideration. Thus, the following appears at 358 P.2d 249:

> "In Umpqua Forest Industries v. Neenah-Ore. Land Co., supra, 188 Or. at page 633, 217 P.2d at page 230, we quoted with approval the following from 59 C.J.S. Mortgages Section 42, p. 78, as the rule upon which appellants rely:
>
> > " 'If the grantor of a deed absolute in form, but alleged to have been intended as a security, was financially embarrassed at the time of its execution, being sorely pressed for money and, therefore, at the mercy of his creditor and unable freely to dictate the terms of his security, this circumstance will be considered as tending to show the intention to create a mortgage.' "

It may be pertinent to observe that in that case the court, which held there had been a sale, specifically observed that it found nothing in the record disclosing that either the plaintiff, Blue River Sawmills, or one Shroyer was being sorely pressed for money or at the mercy of any creditor at the time negotiation was had with Gates. In the case before the Court however, the situation was clearly to the contrary. As the appellant has admitted and as the bankruptcy schedules (Ex. 1)

clearly show, the bankrupt, who had been possessed of substantial assets and was a large rose grower and nursery operator, had been in financial distress for a long period of time, was forced to terminate those operations and ultimately file a petition in bankruptcy.

The second contention in support of appellant's first specification of error is that the finding was inconsistent with the theory upon which the appellee tried the case.

Without conceding this contention, the trial court quite properly made its findings upon the basis of the evidence presented and not upon the theory upon which the parties may have tried the case. *Hormel* v. *Helvering,* 312 U.S. 552, 61 S. Ct. 719, 85 L. Ed. 1037 (1940); *United States* v. *Bess,* 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958); *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.,* 8 Cir., 199 F.2d 511 (1952); *Massachusetts Bonding & Insurance Co.* v. *State of New York,* 2 Cir., 259 F.2d 33 (1958).

In *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.* the following appears at p. 514:

> "There is no doubt that both parties formulated their pleadings and entered upon the trial upon the theory that the contract was still in effect. But that fact in itself would not necessarily preclude the court from treating the pleadings as amended to conform to the issues presented by the evidence. Rules 15(b) and 54(c) FRCP (citations omitted)"

In *Masachusetts Bonding & Insurance Co.* v. *State of New York* the following appears at p. 40:

"On this issue the United States is met with the contention that it waived or lost its claim by failing to assert it before the Referee or the district court. *It appears from the record that this 'lien theory' was never urged below.* It is also clear, however, that the formal claim presented in the proceeding by the U. S., and *other portions of the record, contained sufficient facts to sustain the lien and the priority.*" (Emphasis supplied)

2. Answer to Appellant's Second Specification of Error

The appellant's second specification of error is that the District Court erred when it "refused to give force or effect to the option of September 30, 1951, and appellant's exercise thereof." The issue raised by this specification of error, which was argued by the appellant at the time of the hearing of his objections to the Findings of Fact and Conclusions of Law proposed by the court, also depends for its determination upon the interpretation given to the March 4, 1964, agreement and to this extent does not present a need or different basis for the appellant's position.

The appellant's argument in support of this specification of error is that if the transactions including that of March 4, 1964, were mere options then the original option agreement in favor of the appellant dated September 30, 1951, when the corporation was organized, was still in full force and effect; further that the appellant sought to exercise his rights under that option by letter dated June 30, 1964, to the bankrupt, with a copy to the Referee in Bankruptcy (Ex. 36); and finally that

in view thereof the rights of the bankrupt, and the appellee-trustee as successor in interest of the bankrupt, were limited to the book value of the stock less the sums theretofore received by the bankrupt.

It should first be noted that the alleged exercise on June 30, 1964, of rights under the option instrument dated September 30, 1951, occurred after the bankruptcy petition had been filed on April 16, 1964, after the trustee had asserted rights under the agreement of March 4, 1964 (Tr. 84, 110-111), and after it clearly appeared that there was a conflict between the appellant and appellee (Tr. 110-111). Accordingly, the attempted exercise by the appellant of rights under the option of September 30, 1951, was merely a self-serving gesture.

The position of the appellee relative to the option of September 30, 1951, and the four so-called option documents of December 6, 1961, to February 20, 1963, inclusive, is clearly set forth in the contention made by him in the Pre-Trial Order (R. 38) reading in part as follows:

> "3. The agreement of March 4, 1964, relative to the sale or liquidation of Dering Industries, Inc. must be construed as superseding any and all prior agreements, options, understandings and arrangements between the defendant and the bankrupt, the parties thereto. It was made in contemplation of the sale or liquidation of the capital stock or assets of the corporation by the defendant, and a definite understanding and agreement was reached for a division of the proceeds equally between the parties except that the defendant would receive out of the

bankrupt's share the sum of $10,000.00 plus interest from June 1, 1963."

The court adopted the appellee's contention in Finding 6 (R. 88) contrary to the view expressed by the appellant in his brief (Br. 21). Thus the court, paraphrasing the language of 11 U.S.C. 107d(2)(a), found that there had been a transfer of the bankrupt's equitable interest in the corporation stock to the appellant *within one year prior to* the filing of the petition and adjudication in bankruptcy on April 16, 1964. This finding is supported by the analysis of the March 4, 1964, agreement hereinafter made in the appellee's answer to the appellant's third specification of error. It is submitted that the appellee's analysis of the agreement is correct and that the appellant's attempted construction of Finding 4 to the effect that the March 4, 1964 agreement was a mere option is incorrect. It is clear therefore that the option dated September 30, 1951, had been superseded and the trial court properly disregarded the appellant's contention based thereon.

3. Answer to Appellant's Third Specification of Error

The appellant's third specification in error is:

"The District Court erred in finding that:

'6. Within one year prior to the adjudication of bankruptcy on April 16, 1964, at a time when the bankrupt was insolvent, the bankrupt transferred to the defendant his equitable interest in the stock of the corporation. The only consideration for the transfer was the cancel-

> lation of the bankrupt's indebtedness and accrued interest.'
>
> '8. The transfer and surrender of the bankrupt's equitable interest in the 100 shares of corporation stock, which had a fair market value of $25,120.00 in consideration of the cancellation of the bankrupt's indebtedness and accrued interest thereon, aggregating $10,600.00 was without fair consideration.' "

on the following grounds:

> "a. There was no evidence to support such findings;
>
> "b. Such findings are inconsistent with the finding that the transactions between the parties were security devices."

Although the appellant's grounds for his position are that there was no evidence to support such findings and that the findings are inconsistent with Finding 4 his argument is not related thereto. In appellant's brief there are no material recitals of testimony or other evidence relative to Finding 6, and absolutely no mention of any evidence relative to Finding 8, nor is there any discussion of the claimed inconsistency. The appellant's argument (Br. 22-23) is based entirely upon the Pre-Trial Order, the claimed inadequacy of the contentions of the appellee and Finding 10 that the appellee did not give effective notice of the assumption of the agreement of March 4, 1964 (R. 89).

The appellee will first direct consideration to the findings themselves and the evidence relevant thereto.

Let us assume for the moment that the so-called option document of February 20, 1963, was in fact an option and that the appellant had acquired all of the ownership rights in the stock originally owned by the bankrupt, save and except a mere option in the bankrupt to repurchase. The purported option was by the provisions of paragraph I unlimited as to time so long as the appellant continued to own said stock and so long as the bankrupt paid interest in the amount of $600 annually. Nevertheless, that document contained other provisions whereby appellant could neither terminate the bankrupt's rights in the stock or compel him promptly to repurchase. That provision provided for the giving of 15 days' notice by the appellant in the event of a desire to sell.

When the March 4, 1964 agreement was entered into the appellant had already determined to sell or liquidate the corporation (Ex. 22). If the February 20, 1963 document were in fact a mere option the appellant could simply have given the bankrupt 15 days' notice. There would have been no need to enter into the March 4, 1964 agreement providing for the sale or liquidation of the corporation and the division of proceeds. Why did he not give such notice? Obviously there must have been some reason for his not doing so and entering into the March 4, 1964 agreement. The only explicable reason is that the so-called option documents, including that of February 20, 1963, were not in fact what they purported to be and that the bankrupt in fact had a beneficial interest in the corporation and in 100 shares of stock therein.

When the agreement of March 4, 1964, is examined in the light of the circumstances then prevailing, it provides some interesting observations. The so-called option documents of December 6, 1961, to February 20, 1963, inclusive, at least contemplated a continuing corporation and purported to provide for an option to repurchase stock in such a corporation. The March 4, 1964, agreement specifically provided for its sale or liquidation. Thus, it specifically provided as follows:

> "THIS AGREEMENT CANCELLS [sic] THE OPTION DATED FEBRUARY 20th, 1963, AND SIGNED BY ALONZO W. DERING."

That this was its sole objective except for the apportionment of the proceeds to be derived therefrom is most emphatically evidenced by these further provisions:

> "THIS AGREEMENT IS BEING EXECUTED FOR THE PURPOSE OF SELLING DERING INDUSTRIES, INC., OR IN THE EVENT THAT A SALE IS NOT MADE: TO LIQUIDATE DERING INDUSTRIES, INC. THIS SALE OR LIQUIDATION TO BE STARTED THIS DATE AND BE COMPLETED OR IN THE PROCESS OF COMPLETION BY MAY 31st, 1964.
>
> "IT IS AGREED BETWEEN ALONZO W. DERING AND ELDON P. DERING THAT THIS AGREEMENT WILL BE EFFECTIVE AND NEITHER PARTY TO THIS AGREEMENT CAN STOP THE PROCEEDINGS ONCE STARTED."

The agreement then contains a provision specifying how the proceeds from the sale or liquidation are to be divided and including four subparagraphs. The second

subparagraph, upon which the appellant necessarily relies for his contention that this agreement was an option, states the bankrupt agrees to purchase 100 shares of stock for $10,000 plus accumulated interest from June 1, 1963, to the date of purchase which is to be prior to the date of sale or completion. However, subparagraph 4 provides "*the proceeds from the sale or liquidation of Dering Industries, Inc. are to be divided equally.*" (Emphasis supplied)

The following paragraph sets forth the intent of the agreement, namely to return $20,000 to the appellant, Alonzo W. Dering, plus interest at 6 percent on $10,000. The paragraph further indicates that the excess of over $20,000 is to be equally divided between the appellant and the bankrupt.

It is conceded that some of the provisions of this agreement are ambiguous and in conflict. However, it must be remembered the agreement was drawn by the appellant himself (Tr. 19). It is submitted that the only consistent construction of the agreement is that the appellant was to receive $20,600 and that any additional proceeds were to be apportioned between the parties. With respect thereto the appellant contends that the bankrupt first had to pay the appellant the sum of $10,600 and do so prior to the sale and liquidation of the corporation; and in that event, *and only in that event,* would the bankrupt be entitled to receive one-half of the total proceeds. For this contention to have merit the payment of $10,600 by the bankrupt must be considered a mandatory requirement and the failure of the bankrupt, or the appellee-trustee as his successor, to make such

payment prior to May 31, 1964, must be held to have resulted in a forfeiture of any of their rights to share in the benefits of the sale. However, a court of equity abhors forfeitures.

To declare a forfeiture in this instance would appear to be particularly objectionable. On March 4, 1964, the corporation had in excess of $20,000 in cash as well as other assets free and clear of any and all indebtedness (Tr. 27, 114-115; Ex. 22) and shortly thereafter the appellant realized some $50,240 therefor. Accordingly, there was not the slightest question that there would be $20,600 available for distribution to the appellant ahead of any apportionment of the proceeds to the bankrupt and further that the appellant, since he asserted ownership and control of the corporation (Tr. 14, 25), was in a position to insure that he would first receive such amount. Under such circumstances tender of payment is excused and unnecessary and equity will not require the performance of a useless act.

Also at that time, to defendant's knowledge, the bankrupt had been insolvent at least from November 1, 1963, had been compelled to cease all business operations, was about to file a petition in bankruptcy and was, as both he and defendant well knew, unable to raise the sum of $10,000 plus interest from June 1, 1963. If appellant's contention, under these circumstances, is a proper one, then he and the bankrupt by imposing an impossible condition to the bankrupt's realization of benefits were guilty of entering into an arrangement which would have enabled them to commit fraud under

the provisions of sections 67d (2) of the Bankruptcy Act, 111 U.S.C. 107d (2).

As to Finding 8, the record clearly shows that the appellant received $50,241.47 upon the consummation of the transaction with Moncrief-Lenoir (R. 36; Tr. 115; Ex. 34).

It may be that the precise value of the stock on March 4, 1964, does not appear. However, the appellant's letter of March 3, 1964, to Moncrief-Lenoir (Ex. 22) shows that the corporation then had in excess of $20,000 in cash plus inventory and accounts receivable and a franchise worth $25,000 and no indebtedness of any kind. Further, it appears that the appellant paid himself the sum of $10,000 (Tr. 115) and paid the sum of $600 on behalf of the bankrupt to the appellee as trustee and to the bankrupt (Tr. 77-78). It is submitted that the foregoing clearly establishes that the net worth of the corporation was not less than $50,240 on March 4, 1964, and provides ample basis for the court's finding that a one-half interest in the corporation, that is the bankrupt's equitable interest in 100 shares of corporation stock had a fair market value of $25,120 on that date.

The consideration which the bankrupt received for such one-half interest was a cancellation of his indebtedness, which with accrued interest aggregated $10,600. The March 4, 1964, agreement specifically provides for the cancellation of the so-called option document of February 20, 1963. In view of the court's finding that the February 20, 1963, option document was a

security device, it necessarily follows that the consideration which the bankrupt received for the sale of his equitable interest in the 100 shares of stock, worth $25,120, was simply a cancellation of his indebtedness of $10,600. The court was particularly concerned with this matter as indicated by its interrogation of the appellant's counsel (Tr. 59-60).

Let us now turn to the appellant's argument under this specification of error concerning the contentions of the appellee in the Pre-Trial Order and Finding 10.

The appellee did contend in his first contention that the right and option which the bankrupt had under the February 20, 1963, option document was more than a mere naked option (R. 37). Further, contentions 5 and 6 (R. 39) did raise an issue as to there being a fraudulent and improper transfer on March 4, 1964, within the provisions of section 67d(2) of the Bankruptcy Act, 11 U.S.C., Sec. 107d (2). That the appellant was not misled and was aware that issues were being raised relative to the character of the bankrupt's rights and the nature of the March 4, 1964, transaction is indicated by his second contention (R. 40) and his contentions 7 through 11, inclusive, and the introductory paragraph thereto (R. 41-42). This expressly recognized that the trial court might "hold the options of February 20, 1963, or March 4, 1964, to be security devices" although it evidenced the appellant's erroneous analysis and interpretation of the March 4, 1964, agreement.

However, the appellant's assertions relative to the appellee's contentions and their inadequacy no longer

have any validity. A pre-trial order does not necessarily preclude a court from considering issues not framed therein and making findings of fact relative thereto. Courts have held that a pre-trial order is to be liberally construed and that rigid adherence thereto should not be exacted. 3 Moore, Federal Practice, 2d Ed. 1132; *Smith Contracting Corp.* v. *Trojan Constr. Co., Inc.*, 10 Cir., 192 F.2d 234 (1951); *Rosden* v. *Leuthold*, C.A., D.C., 274 F.2d 747 (1960); *Scott* v. *Spanjer Bros., Inc.*, 2 Cir., 298 F.2d 928 (1962); *Century Refining Co.* v. *Hall*, 10 Cir., 316 F.2d 15 (1963); *Clark* v. *Pennsylvania Railroad Company*, 2 Cir., 328 F.2d 591 (1964).

If it appears to be necessary to amend a pre-trial order to permit a trial court to make findings, the court may do so by the very act of making such findings. *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.*, 8 Cir., 199 F.2d 511 (1952); *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.*, 9 Cir., 292 F.2d 640 (1961); *Interstate Plywood Sales Co.* v. *Interstate Container Corp.*, 9 Cir., 331 F.2d 449 (1964); *Brucker* v. *United States*, 9 Cir., 338 F.2d 427 (1964).

In *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.*, the following appears at p. 643:

> "However strictly appellee may construe the pre-trial conference order, it is clear that the trial court did not construe it so narrowly. The issues determined by the trial court in deciding this case range beyond the question resolved by Findings 5 and 9. Even if the pre-trial order must be read as narrowly as appellee desires to read it, *it must be considered to have been amended by the trial court's*

> *findings. That a pre-trial order can be amended in such 'de facto' fashion, without formal amendment, is well established."* (Emphasis supplied)

In *Interstate Plywood Sales Co.* v. *Interstate Container Corp.* with reference to the appellant's argument that the matter of price was not involved and had been excluded by the pre-trial order the court said at p. 452:

> "Sales Co. also contends that the pre-trial order entirely removed the issue of price uncertainty from the case. However, the pre-trial order included as an issue whether the contract was 'valid and enforceable.' Since a contract is not 'valid and enforceable' if the element of price is missing, the order was sufficient to present the issue of price uncertainty. *And even if the pre-trial order did not include the issue, the order was capable of 'de facto' amendment by the trial court's findings."* (Emphasis supplied)

In this instance the appellant's argument relative to the appellee's contentions in the Pre-Trial Order is not entitled to consideration, since the situation is one in which the Pre-Trial Order was amended by implied consent pursuant to the provisions of Rule 15(b), F.R. Civ. P., 28 U.S.C. and the court's findings are entirely consistent with the Pre-Trial Order as thus amended.

Implied consent is found by evidence introduced without objection and issues so tried are treated as if they had been raised in the pleadings. *Southern Pacific Co.* v. *Libbey,* 9 Cir., 199 F.2d 341 (1952); *Shelley* v. *Union Oil Co. of Cal.,* 9 Cir., 203 F.2d 808 (1953); *Glens Falls Indemnity Company* v. *United States,* 9 Cir.,

229 F.2d 370 (1955); *Kirk* v. *United States*, 9 Cir., 232 F.2d 763 (1956); *Hall* v. *National Supply Co.*, 5 Cir., 270 F.2d 379 (1959); *Rosden* v. *Leuthold*, C.A., D.C., 274 F.2d 747 (1960); *June T., Inc.* v. *King*, 5 Cir., 290 F.2d 404 (1961); *Securities and Exchange Commission* v. *Rapp*, 2 Cir., 304 F.2d 786 (1962); 3 Moore, Federal Practice, 2d Ed., 983, 984.

In *Shelley* v. *Union Oil Co. of Cal.* testimony relative to contributory negligence was developed both on direct and cross examination. The court gave an instruction thereon although contributory negligence had not been raised by the answer. The following appears in the court's opinion at p. 809:

> "The situation would appear to be governed by rule 15(b) providing that *when issues not raised by the pleadings are tried by express or implied consent of the parties, they are to be treated in all respects as if they had been formally raised.* Compare Balabanoff v. Kellogg, 9 Cir., 118 F.2d 597; Rogers v. Union Pac. R. Co., 9 Cir. 145 F.2d 119. It is plain that the experienced judge who presided at the trial regarded the issue of contributory negligence as having been brought into the case by implied consent and consequently felt obliged to instruct in respect of it." (Emphasis supplied)

In *Glens Falls Indemnity Company* v. *United States* the court said at p. 375:

> *"The issue of failure of performance of conditions precedent was not specifically raised by the pleadings or urged at the trial below.* Considering the nature of the case and the multiple issues framed and litigated by the parties, the findings and con-

> clusions fully determined every substantial question of fact and law presented. *The question of performance by Radkovich was completely litigated. Issues actually tried are deemed raised in the pleadings.* Federal Rules of Civil Procedure, Rule 15(b)." (Emphasis supplied)

The issues upon which Findings of Fact 4, 6 and 8, to which the appellant has made reference, and Finding 3, which was integrally related to Finding 4, are based, were fully developed by testimony introduced without objection by the appellant—indeed in part by the appellant himself. The various so-called option documents were specifically set forth in the Pre-Trial Order. The nature of the transaction between the parties, the obligations of the bankrupt to repay the sum advanced, together with interest, the participation of the bankrupt in profits, and related matters considered by the Court, were all the subject of specific testimony by the appellant.

Since the issues upon which the Findings of Fact and Conclusions of Law were based were fully tried, the court was called upon to make findings thereon. 3 Moore Federal Practice, 2d Ed. 996 where the following appears:

> "It should be noted that Rule 15(b) is not permissive in terms: it provides that issues tried by express or implied consent *shall* be treated as if raised in the pleadings. In a court case, the court must make findings on such issues."

And see *Securities and Exchange Commission* v.

Rapp, 2 Cir., 304 F.2d 786 (1962) in which the court said at p. 790:

> "In the district court Judge Murphy gave judgment for defendants dismissing the complaint. The principal ground of decision appears to have been that the pleadings did not conform to the proof; he denied a motion, made at the close of argument, to amend the pleadings so to conform. This ruling was clearly in error. F. R. 15(b) provides that '[w]hen issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings.' *This is mandatory, not merely permissive.*" (Emphasis supplied)

It is submitted, therefore, that the appellant's argument in support of his third specification of error must necessary fail.

4. Argument for Affirmance of Judgment

The judgment of the trial court must be affirmed in the absence of a showing by appellant that the trial court's Findings of Fact are clearly erroneous. Rule 52a, F.R. Civ. P., 28 U.S.C.; *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.,* 8 Cir., 199 F.2d 511 (1952); and *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.,* 9 Cir., 292 F.2d 640 (1961).

Rule 52a, F.R. Civ. P., 28 U.S.C. provides in part

> "Findings of Fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

In *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.* the following appears at p. 514:

> "Under the well recognized rule that the findings of fact of a trial court may not be set aside unless clearly erroneous, we examine the evidence in the light most favorable to the finding and *if there be substantive evidence to support it, we may not set it aside.*" (Emphasis supplied)

In *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.* the following appears at p. 644:

> "Both the finding of no further damage, and that an 'equitable adjustment' of all damage had been made, are findings of fact, not subject to review or change by this appellate court unless clearly erroneous (Fed. R. Civ. P. 51, 28 USCA). On the record before us, particularly, we cannot come to any such conclusion as a matter of law."

It is submitted that the appellant has not shown that the trial court's findings were clearly erroneous. On the contrary, as has been shown by the appellee, there is an abundance of evidence in support of the court's findings.

With respect to the credibility of the witnesses, it is submitted that this may well have been a factor. There was a conflict in the testimony of the appellant (Tr. 43, 110) and that of the Honorable Estes Snedecor, Referee in Bankruptcy (Tr. 84), as to what transpired following the taking of the defendant's testimony before the Referee on June 11, 1964, and the assertion of claims by the trustee under the March 4, 1964, agreement. There was a conflict in the testimony of the appellant

(Tr. 29-30, 79, 113) and that of Mr. Zanley Galton (Tr. 79, 98-99, 101) relative to negotiations with respect to the sale of the corporation and the price thereof.

It would further appear that the trial court, from its frequent inquiries (Tr. 31, 66-67, 72, 80-1, 98), was skeptical concerning the appellant's testimony relative to the value placed by him on the franchise (Tr. 64-66, 79), that a price of $10,000 for the franchise was requested by him of Mr. Galton and particularly that an offer of $25,000 therefor was made by Moncrief-Lenoir without any mention or suggestion of that amount by the appellant (Tr. 31, 64, 78).

CONCLUSION

It is respectfully submitted therefore that the Findings of Fact and Conclusions of Law are amply supported by the evidence, that the appellant has failed to show that they are clearly erroneous and that the judgment in favor of the appellee should be affirmed.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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